AP Microeconomics
Test: Basic Economic Concepts
Instructor's Version

Answers: Free-Response Questions

1. Economic Analysis

A. Define opportunity cost. (2 points) **How is it used in economic analysis?** (3 points)

Definition: The opportunity cost of a choice is the value of the next best alternative that wasn't chosen.

Explanation: A consideration of opportunity costs helps someone determine what is in his or her self-interest. By choosing the alternative that minimizes opportunity costs, a person maximizes his or her benefit.

2 points for the definition, 1 point for first sentence in explanation, 2 points for second sentence in explanation.

B. What are sunk costs? (2 points) **How are they used in economic decision making?** (3 points)

Definition: Sunk costs are costs of choices already made.

Explanation: Sunk costs don't need to be considered in a decision because they can't be avoided, as they are choices made in the past. Only new costs and benefits are considered in economic decision making.

2 points for the definition, 1 point for first sentence in explanation, 2 points for second sentence in explanation.

C. Suppose your MP3 player cost $30 in repairs over the past six months. If it stops working again, requiring another $30 in repairs, would you repair it or replace it? Use the concept of sunk costs in your explanation. (6 points)

Depending on the original value of the MP3 player, one may choose to replace it over getting it repaired. The cost of past repairs is a sunk cost and cannot be recovered, but it may be an influence in replacing the MP3 player rather than paying for more potential repairs in the future.

Key ideas: Sunk costs are unrecoverable (3 points), repair it only as long as the expected benefits outweigh the expected costs (3 points).

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2. Define absolute and comparative advantage. (6 points)

Absolute advantage is the ability of a producer to use fewer resources than other producers. Comparative advantage is when opportunity cost of a certain kind of production is lower for one producer.

3 points for each definition.

3. List the four steps in the scientific method. (4 points)

1. Identify and define the key variables
2. Specify your assumptions
3. Make a hypothesis
4. Test the validity of the hypothesis

1 point for each.

4. Positive and Normative Economics

A. What is the difference between positive and normative economics? (4 points)

Positive economics deals with "what is." Normative economics deals with "what should be."

2 points for each sentence.

B. Write a positive economic statement about trade. (3 points)

Positive economists point out that there are gains to be had through trading because of specialization. Specialization shifts the production possibilities frontier outward.

2 points for the first sentence, 1 point for the second sentence.

C. Write a normative economic statement about trade. (3 points)

Normative economists point out that the gains from trading and specialization do not benefit everyone. Some workers in countries that specialize and trade will lose their jobs to other countries.

2 points for the first sentence, 1 point for the second sentence.

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5. Production Possibilities Frontier (PPF)

A. Describe the PPF and explain what it shows. (3 points)

The PPF is a graph showing all of the combinations of production, given a certain set of resources. The PPF shows the opportunity cost of a production decision.

2 points for first sentence, 1 point for second sentence.

B. Draw a PPF that represents the tradeoffs for producing bicycles or motorcycles. (3 points)

The PPF should show the quantity of bicycles on one axis, motorcycles on the other axis, and a concave PPF.

1 point for each axis label (2 points total), 1 point for a concave PPF.

C. Use a graph and a written description to explain what happens when an oil shortage leads to reduced supplies of synthetic rubber, a resource used for both bicycle and motorcycle tires. (3 points)

Graph: Same graph from Part B with an additional curve further to the left.

Explanation: Any time the amount of resources available for use is decreased, the PPF shifts inward.

1 point for the graph, 2 points for the explanation.

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